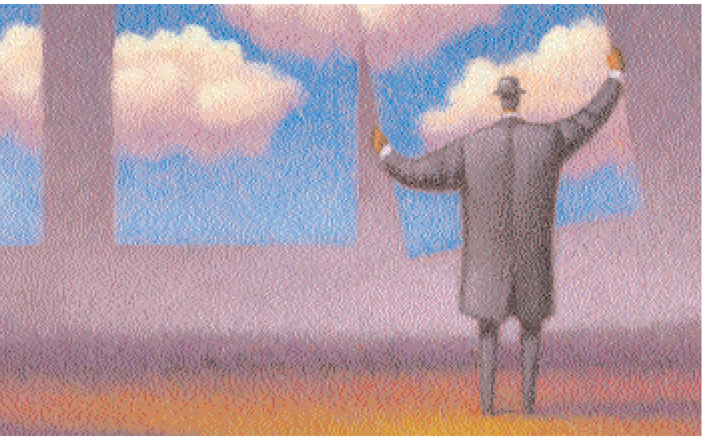
Independent Research: To Be or Not to Be?



By Janine Dusossoit

Jennifer Smart, IRO for CyberClink Corp., was in a dilemma. The stock had become an "orphan" since the dot-com crash wiped out what had been a $3.2 billion market cap. The broad research coverage the company had enjoyed during the glory days of the 1990s had dried up. Although Smart had explained to management that it was unrealistic to expect to regain sell-side coverage until the company increased in cap size — now hovering around $200 million — the new CEO had made it perfectly clear that he expected her to get more analysts to write research reports and raise the visibility of CyberClink on Wall Street and among individual investors.

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"I don't care what it takes," said Mickey Manager, CEO of CyberClink. "We've got to get the word out about what we've done to turn this company around and why the stock is such a great value! The shorts are killing us!" The stock had been slipping steadily over the last two months and had closed last week at $1.25.

In addition to IR, Smart also wore the corporate communication hat and had initiated a public relations campaign to generate more news about the company's customer wins, its new leadership and the accolades it had received for its technology. This had produced modest results in industry trade publications and local media. Her team had redesigned the Web site, adding downloadable financial statements and other data useful for investors and analysts. But efforts to attract new sell-side research and new institutional investors continued to come up short. The company's market cap was just too small.

If only she could find a truly independent analyst to write an objective, third-party report, Smart thought. The next morning, while reading *The Wall Street Journal*, she smiled when she saw an article about an alternative for small-cap companies with little or no research coverage: "independent" research facilitated by a new kind of company. "This might be the answer," she thought. After further research, she found that companies like the one mentioned in the *Journal* article were popping up everywhere. But how "independent" were these companies if the issuer had to pay for the research? How did these "independent" firms acknowledge to the investing community that the companies they were covering paid for the research? And what if the analyst issued a "sell" recommendation? There were so many ambiguities surrounding the independent research companies, Smart felt uncomfortable pursuing this option.

Then Smart recalled that NIRI had issued guidelines for issuer-paid research, four principles to guide her if she chose that route:

1. That it be fully disclosed in the research document that the company paid for it.

2. That it be written by a qualified analyst.

3. That the compensation for preparing the research be in cash only.

4. That the research report not contain any recommendation to acquire the stock or price targets.

(These guidelines were further expanded in 2004 when NIRI and CFA, in a joint effort, issued "Best Practice Guidelines Governing Analyst/Corporate Issuer Relations." For the full report, go to www.niri.org/irresource_pubs/pdfs/CFAI-NIRIGuidelines.pdf.)

Smart called several of her colleagues at small-cap companies to ask if they had considered paying for research reports and, if so, whether it had been an effective tool in targeting institutional investors. The results of her survey were mixed. Before committing to one of these new independent research firms, she concluded, maybe there were yet-untapped opportunities to get CyberClink's story out to the investing public.

Smart sat back and contemplated the bull and bear bookends on her credenza. "What we need to do is reach as many investors with our story as possible," she thought. "Why not step up our outreach, make a concerted effort to identify and target a dozen small-cap sell-side analysts at independent research boutiques to introduce them to the company, and present a coherent case for their initiating research? Let's get the CEO, who is so passionate about the business, out on the road more often to speak at targeted investor forums that cater to small-cap stocks. Maybe we can even wrangle a spot on a panel at an industry conference or two."

In the meantime, Smart decided to monitor independent research companies and how institutional investors were receiving their work.

She tossed a Nerf ball into the hoop attached to her bookcase and sat down to compose a memo outlining her recommendations to management. IRU

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